Service Date: December 9, 1986

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER of the Application of the BUTTE WATER COMPANY for Authority to Increase Rates and Charges for Water Service to its Butte, Montana Customers.	UTILITY DIVISION DOCKET NO. 86.3.7 ORDER NO. 5194b

ORDER ON PETITION FOR RECONSIDERATION

BACKGROUND

1. On October 3, 1986, the Montana Public Service Commission (Commission) issued Order No. 5194a disposing of all matters then pending in this docket. On October 15, 1986 the applicant, Butte Water Company (BWC), filed a Motion for Reconsideration on three issues:

i.) Net operating loss carry forward.

ii.) ii.) Profits from asset sales and labor and supplies.

iii.) iii.) Electric expense incurred by the company.

2. BWC filed a brief on this matter on October 29, 1986. At a November 25, 1986, worksession scheduled at the regularly held agenda meeting November 24, 1986, the Commission consider these issues and found no grounds for modifying Order 5194a.

NET OPERATING LOSS CARRY FORWARD

3. BWC requests reconsideration of the Commission's treatment of the NOLs that could be available to reduce BWC's

taxable income. Generally for ratemaking purposes NOLs from prior periods are subtracted from current taxable income to calculate tax expense. BWC urges this Commission to ignore BWC's past NOLs in calculating its taxable issue income and resulting tax expense. This was addressed at paragraphs 98 through 104 of order NO. 5194a.

4. BWC incurred tax net operating losses of $3,376,243 from 1974 through 1985. In its brief supporting its motion for reconsideration BWC states the following reasons why the Commission should reconsider including NOLs in calculating tax expense:

a. BWC will receive no future benefits from the NOLs. A substantial portion of the NQL resulted from interest on intercompany borrowings. This interest was eliminated on a consolidated tax return. Any NOLs that were available were used by ARCO, its former parent, to offset income tax liabilities of r-ofitable enterprises on a consolidated return.

b. BWC's debt was the result of loans from ARCO to offset the operating losses. The fact that the NOLs approximate
ly equal the cash loaned by ARCO "makes the exchange a wash and confers neither a benefit nor a detriment on either the rate payor or the investor." Brief page 5.

c. The NOL issue in this docket is unique because of the conversion of debt to equity that resulted from the purchase from ARCO. BWC asserts that ARCO could have declined to convert debt into equity and this would have been detrimental to the ratepayer.

The Commission does not find any of these arguments persuasive reasons for reconsidering Order No. 5194a or deviating from its prior orders.

5. BWC's argument (a). Intercompany eliminations. From 1974 through 1981 BWC sustained total net operating losses of $2,257,802. These losses were not caused by interest on intercompany borrowirgs; interest payments to ARCO did not start until 1982. Any interest expense during 1974 to 1981 was paid to a third party lender, Crocker National Bank. "Response to staff data request No.20). Since the interest expense was paid to a third party during this time, no intercompany elimination occurred and a contention that the equity investor received no tax benefit from the net operating loss is incorrect. In Order No. 5194a the Commission considered BWC's argument that because no NOLs are actually available to reduce taxable income the NOLs should be ignored in calculating income tax expense for ratemaking purposes. At paragraph 101 the Commission stated, "However, no NOLs are available to BWC for tax reporting purposes because ARCO elected to use BWC's net operating losses to offset taxable income of other profitable enterprises. BWC as well as the BWC ratepayer would have benefitted from these NOLs if they were available. Nothing prevented BWC from retaining the NOLs. It would be inequitable to the ratepayer to deny it the benefit of a tax savings that BWC could have retained but chose not to.

6. BWC's argument (b) and (c). BWC unique because NOLs

approximate loans from ARCO and ARCO could have declined to convert debt into equity.BWC generated and did not use NOLs that reduce taxable income. For ratemaking could be available to purposes the NOLs must be considered to calculate BWC's tax expense. Any tax benefit accruing to a regulated utility must remain with the utility until such time as it can be used by the utility. To do otherwise would prevent the ratepayer from realizing the effects of such tax benefits.

GAIN ON SALE OF PROPERTY

7. BWC requests reconsideration of 1) the Commission's inclusion in revenue of $94,754, which is a two year amortization of a $189,509 gain realized from the sale of land, and 2) inclusion of $11,655 labor and supply profits.

8. Gain from sale of land. The Commission considered this issue at paragraphs 35 through 50 or Order No. 5194a. At paragraphs 42 and 43 the Commission stated:

There is no hard and fast rule to determine who should benefit from the gain. In every rate case, the Commission must balance its obligations to the equity investor to maintain financial integrity, attract necessary capital, and fairly compensate investors with its obligation to the ratepayer to set reasonable rates and protect the relevant existing and foreseeable public interest.

The unicue facts and circumstances of each rate case influence this balancing. In this case, the Commission finds MCC's method to be an equitable way to determine whether the ratepayer or the equity shareholder should benefit from the gain. As MCC points out in its brief, this test was set out in Democratic Central Committee of District of Columbia et al. v. Washington Metropolitan Area Transit Company, 485 F.2d 786, 806 (1973). As stated in that case:

"We think two accepted principles which have served comparably to effect satisfactory adjustments in other aspects of ratemaking can do equal service here." (footnotes omitted)

The two principles referred to are: one, right of gain follows risk of loss and two, economic benefits follows economic burdens.

9. In its brief for reconsideration BWC agrees with the Commission's method of analysis but argues that "The position taken by the Butte Water Company is the position that will protect the relevant existing and foreseeable public interest, and the position taken by the Consumer Counsel will be a detriment to it. The evidence produced during the course of the hearing establishes that the water plant in Butte, Montana has suffered substantial repair, through years of neglect and is in need of improved maintenance, and replacement. It costs money to do funds would be the these things, however. One source of those liquidation of assets not really needed by the company." Brief at page 8.

10. BWC has a legal obligation to maintain reasonably adequate facilities. In this docket Butte Water Company testified extensively on the deteriorated state of its plant. The Commission made no finding on the condition of the plant but noted that BWC did not have a capital improvement program or any long term planning that indicated BWC has consider various alternatives and intends to make the necessary, cost effective improvements to its system. See paragraphs 123 through 129 Order 5194a. In the future, if the appropriate circumstances arise and if BWC establishes that it intends to meet its obligation of maintaining adequate facilities, including transmission and distribution, the Commission would be willing to consider allowing the proceeds from the sale of assets to be used as a source of funds for necessary improvements.

11. Labor and supply profits. This issue was discussed at paragraphs 25 through 30 of Order No. 5194a. In the past the Commission treated this as a "below the line" item, allowing the profit from the sale of labor and materials to benefit the equity

investor. Order No. 5194a-was the first time the Commission specifically addressed the issue of the proper treatment of this item. Montana Consumer Counsel (MCC) proposed that the Commission change its prior policy. MCC argued that because the ratepayer bore the expense for labor and paid a return on the material the net profit generated from this activity should benefit the ratepayer.

12. BWC urges the Commission to reconsider including the $11,655 as a contribution to BWC revenue. "The fact of the matter is that the items are paid for by the sale of the items to people who need pipe, couplings, fittings, and who occasionally drive their cars into fire hydrants. These items are not used to provide water service to the public at large." (Brief at 13).

13. BWC has not established that the these profits are nonutility revenues that should be treated as a "below the line" item. BWC's response to PSC data request one established that the ratepayer paid for the items that produce this profit. The ratepayer bore the expense, therefore, the net profit generated from this activity should be included as revenue.

ELECTRIC EXPENSE

14. In its rate application BWC proposed a proforma adjustment increasing by $84,929 its actual electrical expense of $395,857. In its brief supporting the motion for reconsideration BWC argues that the evidence submitted at the hearing establishes there was a change in operational policy that will contribute to higher electrical expense in 1986 and 1987.

15. The increase in power expense reflected increased pumping in 1986 because of 1985 drought and higher Montana Power Company rates. The pumping requirements at two pump stations are

the major factors of BWC's electrical expense. PSC staff requested data regarding total gallons pumped and the kilowatt hour usage for the two stations during the period 1982 through 1984.

16. Based on the information BWC submitted in its rate application and in response to data requests, the Commission staff prepared a schedule of gallons pumped and electricity used for the period 1982 through 1985. BWC's 1985 actual total gallons pumped and total kilowatt hours of electrical usage are substantially above levels experienced from 1982 to 1984. BWC's witnesses stated that the increased electrical consumption resulted from increased pumping to meet consumer demands during the 1985 drought and to pumping water from the Big Hole to recharge the Basin Creek Reservoir that was depleted because of the drought.

17. Even though 1985 actual electrical usage was substantially above historical levels, BWC proposed an adjustment to increase this expense for ratemaking purposes. The evidence on the record showed that during 1982 and 1983 it was BWC's policy to pump during the winter months to refill reservoirs, but the total pumped water and total kilowatt hours of usage for those two years are significantly below the level experienced in 1985 and the proforma level projected by the BWC.

18. The historical data on the total pumped water and total kilowatt hours of usage from the years 1982 and 1983 did not support BWC's assertion that increased electrical expense will result because of its operational policy change. The evidence shows that increase in electrical expense is attributable to the effects of the 1985 drought.

19. BWC will incur proforma electrical expenses that are in excess of the normalized level because of its effort to

recharge the Basin Creek Reservoir, but those expenses are nonrecurring in nature. In Order No. 5194a the Commission allowed BWC to recover the difference between normalized electrical expense and the proforma level by amortizing the difference over BWC projected total proforma electrical
a two year period. expenses of $480,786. Subtracting the normalized level of $348,033 from this figure results in a difference of $132,753 to be amortized over two years. The evidence on the record supports this treatment for electrical expense.

CONCLUSIONS OF LAW

1. Butte Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over Applicant's rates and service pursuant to Section 69-3-102, MCA.
2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.
3. The rates and rate structure approved Order No. 5194a are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

NOW, THEREFORE, IT IS ORDERED THAT:
1. Butte Water Company's motion for reconsideration is denied. Butte Water Company shall file rate schedules which reflect an increase in annual revenues of $142,322 for its Butte, Montana service areas. The increased revenues shall be generated by increasing rates and charges to all customer classifications on a uniform percentage basis.
2. The rates approved in Order No. 5194a shall be effective when

approved by the Commission.

3. The revenues approved in Order No. 5194a are in lieu of those approved in Order No. 5194.

4. DONE IN OPEN SESSION at Helena, Montana, this 8th day of December, 1986, by a 3 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

ATTEST:

Ann Purcell
Acting Secretary

(SEAL]

NOTE: You may be entitled to judicial review in this matter. Judicial review maybe obtained by filing a petition for review within thirty (3) days of the service of this order. Section 2-4-702, MCA.